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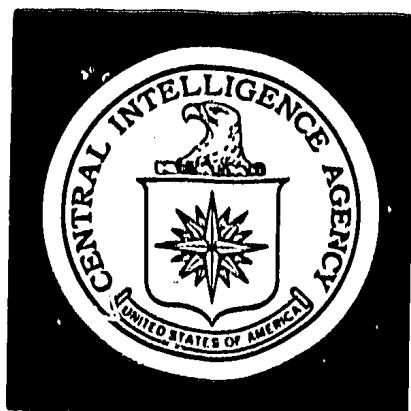

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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

Philippine Balance-Of-Payments Troubles

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ER IM 70-175
December 1970

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
December 1970

INTELLIGENCE MEMORANDUM

Philippine Balance-Of-Payments Troubles

Introduction

The Philippine balance-of-payments situation, which had deteriorated sharply in the late 1960s, became critical last year when the country was unable to meet scheduled debt repayments. Manila is seeking massive financial assistance, mainly from the United States, in the hope of resolving its difficulties, but is also using the United States, with its large military and economic presence, as a scapegoat for the Philippines' economic problems. This memorandum examines the background of the balance-of-payments problem, assesses recent efforts at monetary reform, and estimates the balance-of-payments outlook through 1974.

Economic Background

1. During the 1950s the Philippine economy expanded fairly rapidly with real gross national product (GNP) increasing by nearly 7% annually. Manufacturing output rose 11% annually from 1950 through 1959, chiefly because consumer goods industries, protected by high tariff walls and import restrictions, were established to supply the domestic market. Agriculture grew about 7% a year -- reflecting primarily large increases in sugar production for the US market.

Note: This memorandum was produced solely by CIA. It was prepared by the Office of Economic Research and was coordinated with the Office of Current Intelligence and the Office of National Estimates.

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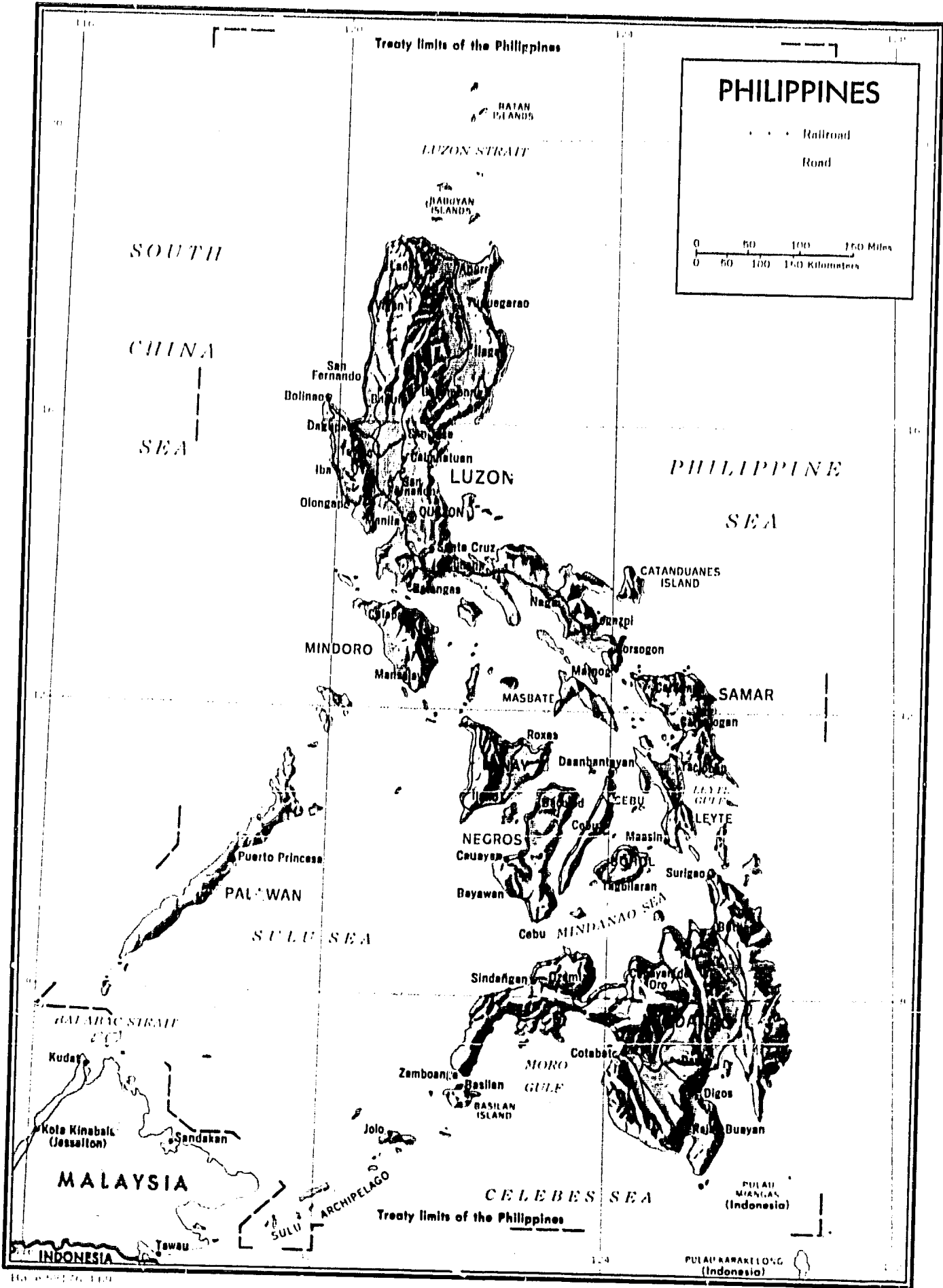
2. Despite this progress, few foundations were laid for sustained economic growth. Actually the seeds were sown for problems in the 1960s. Profitable investment opportunities in import-substitution industries were becoming limited; many new firms were essentially assembly operations, operating at high cost in a small protected market and few were able to compete in export markets. At the same time, little effort was made to modernize agriculture, and most of the increase in farm output was attributable to expanding the area under cultivation.

3. The main concern of the Philippine political-economic elite, a relatively few wealthy families, was to preserve and expand its interests rather than to foster economic development with its accompanying influx of competing foreign investors. Ownership of the most productive lands, and prevalence of a tenancy system that gave little protection to peasants' interests, put the oligarchy in a position to keep much of the gains from increases in agricultural output. And the system of import licensing and high tariffs permitted the favored few to make large profits from industrial ventures. For most Filipinos there was little or no improvement in living conditions.

4. Economic growth slowed sharply during the 1960s, with the growth of farm output averaging about 4% annually and that of industrial output 6% -- about half the rates of the previous decade. Real GNP during 1960-69 probably increased by some 4% to 5% annually, but since population growth was 3.5%, there was little real per capita gain. The slowdown in agriculture reflects the fact that most of the better land had been brought under cultivation during the 1950s and that investment remained minimal. The only major gain was a large increase in rice production in 1968, following a one-third increase in the government support price, which made it profitable to greatly expand plantings of high yielding varieties.

The Balance-of-Payments Problem

5. Domestic economic problems did not seriously affect the foreign sector until the late 1960s. During the early and mid-1960s, foreign exchange



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reserves even rose slightly. Imports and exports increased at about the same rate, and during 1960-66 the trade deficit averaged only about \$10 million a year. The 1962 devaluation and other restrictive measures held down import growth while some shift of smuggled exports to legal channels occurred. Import growth was adequate for the slow economic growth achieved. The small trade deficit was more than offset by US military spending, which rose rapidly after 1963 owing to the Vietnam War. As a result, the current account balance during 1960-66 registered an average annual surplus of nearly \$50 million.

6. Beginning in 1967 the situation deteriorated sharply. The current account showed a \$97 million deficit in that year, compared with a \$117 million surplus a year earlier (see Table 1). The deficit more than tripled in 1968 and remained high in 1969 at about \$286 million. The chief cause was a rapid deterioration in the trade account. Although imports normally exceeded exports, trade was in deficit by \$224 million in 1967 and an average of \$270 million in 1968 and 1969 (see Figure 1).

7. Exports rose by about 6.5% annually during 1961-66 and only 1% during 1967-69 largely reflecting the failure to develop new commodities to supplement traditional agricultural exports. In 1969, manufactured goods constituted only about 8% of total exports, compared with about 5% in 1960. Only two relatively new commodities showed any marked increase during the 1960s -- copper and timber (see Figure 2). Timber exports more than doubled between 1960 and 1966, accounting for about half of the growth in total exports in this period, but subsequently slowed sharply because of deforestation. Exports of copper concentrate developed fairly rapidly in the latter 1960s in response to growing demand in nearby Japan and a general world shortage, but increased copper sales barely offset losses in traditional farm exports. World demand for the kinds of agricultural products the Philippines export grew slowly, and the failure to modernize agriculture caused production of major export crops to increase even slower than world demand. Copra output, for example, after increasing through 1966, changed little thereafter. The Philippine share of world copra exports fell from about 65%

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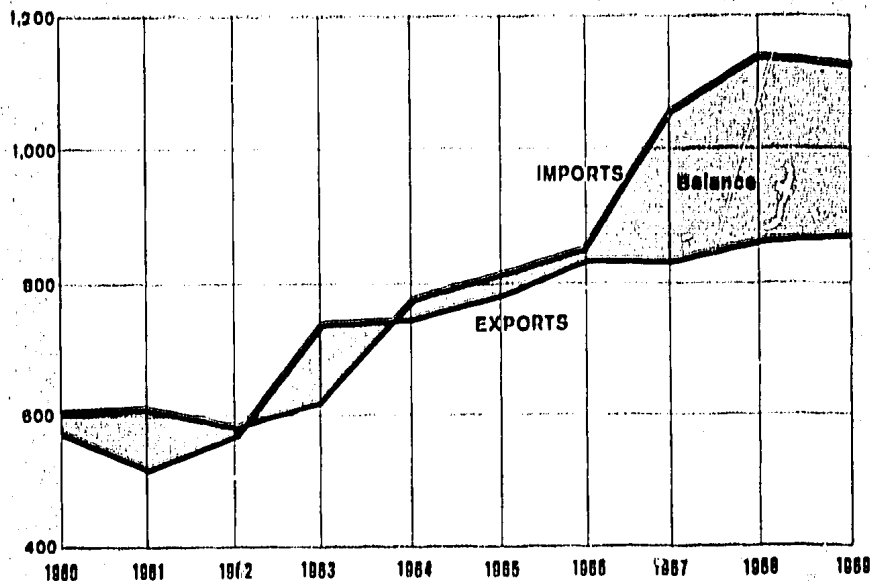
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Figure 1

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PHILIPPINE TRADE BALANCE

(Million US \$)



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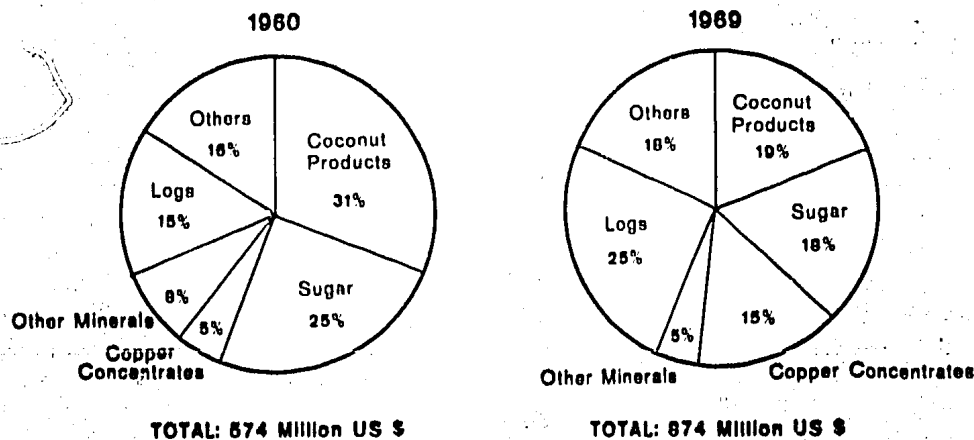
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Figure 2

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PHILIPPINE EXPORTS



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Table 1
Philippine Balance of Payments

	Million US \$									
	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969
<u>Current Account</u>										
Trade balance	-30	-96	-16	122	-23	-24	-9	-224	-284	-257
Investment income	-75	-30	-15	-15	-26	-31	-37	-76	-97	-78
Private transfers	80	76	79	65	93	73	52	113	90	104
US military expenditures a/	11	21	16	20	25	42	57	79	96	55
Other services b/	-50	-54	-45	-21	0	51	54	11	-109	-110
Total	-64	-83	19	171	69	111	117	-97	-304	-286
<u>Long-term capital movements</u>										
Private direct investments	29	-56	-3	-4	-4	-10	-15	-9	-5	2
Private long-term loans	28	70	3	-26	38	-11	3	12	107	85
Government long-term loans and grants	82	3	17	12	22	45	39	64	84	61
Total	139	17	17	-18	56	24	27	67	186	148
<u>Short-term capital movements</u>										
Private Philippine institutions	-3	-24	-34	57	-70	-106	-99	-44	182	92
Central Bank of the Philippines	5	57	-15	-14	16	125	12	34	-52	68
Total	2	33	-49	43	-54	19	-87	-10	130	160
<u>Net errors and omissions</u>	-44	-40	19	-161	-51	-75	-56	-24	-103	-63
<i>Change in foreign exchange reserves</i>	33	-73	6	35	20	79	1	-64	-31	-41

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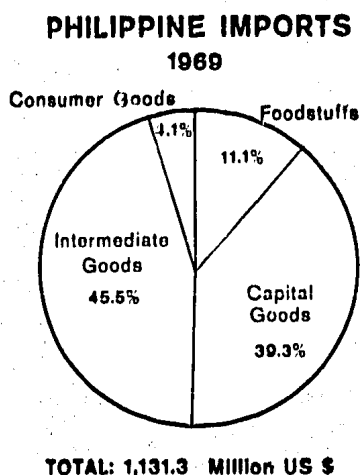
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in 1960 to about 55% in 1969. Sugar production grew by about 2% a year during 1960-69, and for most years during the 1960s the Philippines was unable to meet its quota in the US market. Other traditional farm exports, such as abaca, have suffered from declining world demand. If not for rising export prices between 1966 and 1969, total export earnings would have actually declined.

8. While exports stagnated, imports increased dramatically after 1966. Despite a slight drop in 1969 they were still one-third higher than in 1966. When President Marcos came into power at the start of 1966, his administration adopted policies aimed at stimulating economic growth. Public investment spending more than doubled from 1966 to 1967. Easy credit policies combined with large budget deficits financed principally through central bank borrowing led to sharp increases in the domestic money supply. Local production satisfied much of the resulting increased demand for consumer goods. But this in turn was quickly translated into a higher demand for imports because many Filipino industries rely heavily on foreign goods. While import substitution policies had greatly reduced the country's dependence on imported finished consumer goods, more than half its semi-processed goods and about 85% of its capital equipment are imported. Among raw materials, all crude oil and almost all textile industry inputs are purchased abroad (see Figure 3 for the commodity composition of imports).

Figure 3



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9. An outflow of foreign capital also caused problems. During the 1960s the net outflow of private direct foreign investment totaled about \$75 million, primarily US-owned. In addition, in recent years the investment income outflow has increased steeply and during 1967-69 was nearly \$250 million, compared with about \$95 million during the previous three-year period. Furthermore, the large and continuous debit entry in the balance-of-payments ("errors and

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omissions") which is needed to equate foreign exchange receipts to foreign exchange spending, averaged about \$65 million annually during 1967-69 and almost certainly reflected capital flight.* These outflows stem in large part from foreigners' basic lack of confidence in the Philippines as a profitable and secure place to invest. The economic oligarchy, through its strong position in the government, has sought to reduce the role of the foreign investor and thereby increase its share of the economy. Broad popular support for the oligarchy's anti-foreign investment policies has been obtained by playing on nationalistic sentiment which has resulted in a hostile atmosphere for non-Filipino investors. Another important condition adversely affecting the foreign investor is corruption. When combined with considerable bureaucratic red tape, the extensive corruption siphons off a large part of the potential profits and greatly hinders day-to-day business operations.

10. Increased US military spending and foreign aid receipts kept the payments situation from being even worse. Total US military expenditures accruing to the Philippines were \$86 million in 1965 but rose sharply thereafter. During 1967-69, earnings from this source averaged about \$195 million annually, mainly reflecting higher spending associated with the Vietnam war (see Table 2). Foreign aid receipts also increased somewhat, averaging about \$120 million a year during 1967-68, compared with about \$95 million during 1964-66 (see Table 3).

Table 2

US Military Spending Accruing to the Philippines

Million US \$								
<u>1961</u>	<u>1962</u>	<u>1963</u>	<u>1964</u>	<u>1965</u>	<u>1966</u>	<u>1967</u>	<u>1968</u>	<u>1969</u>
51.5	55.0	48.9	62.6	86.1	153.0	206.5	180.0	197.8

* *Capital flight can occur through a variety of techniques. Probably the most prevalent in the Philippine case is underreporting of exports and overreporting of imports. In both cases, such actions enable a foreign trader to build up foreign exchange accounts overseas.*

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Table 3
Philippine Foreign Aid Receipts

	Million US \$				
	1964	1965	1966	1967	1968
United States	57.0	51.4	30.0	45.0	43.0
Japan <u>a/</u>	21.4	35.3	30.5	61.5	27.8
Other bilateral	2.2	11.5	3.6	5.2	19.1
International organiza- tions	11.6	19.2	15.7	18.4	18.5
<i>Total</i>	<i>92.2</i>	<i>117.4</i>	<i>79.8</i>	<i>130.1</i>	<i>108.4</i>
<i>a. Including reparations.</i>					

Financing the Deficit

11. Beginning in 1967, Manila resorted to large-scale foreign borrowing to finance its current account deficits, which averaged almost \$230 million a year during 1967-69. As a result there was soon built up a large short- and medium-term debt with a repayment schedule clearly beyond the country's capability. In September 1969 the total external debt was \$1.5 billion, almost two-thirds of which were short- and medium-term obligations. Roughly half the debt was owed to the United States (see Table 4). Until mid-1969 the heavy debt servicing requirements were met by new loans, by converting some short-term obligations into longer term ones, and by drawing down foreign exchange reserves. By the fall of 1969, however, the country's international financial position had so deteriorated that these options were no longer available and Manila was forced to postpone virtually all scheduled repayments. By the end of 1969, gross foreign exchange reserves had fallen to about \$121 million -- roughly equal to only six weeks of imports. The debt moratorium was continued into 1970 when scheduled debt repayments were \$540 million.*

* Debt owed as of April 1970, but excluding \$298.4 million in revolving credits and IMF obligations.

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Table 4

Philippine External Debt as of September 1969

	Million US \$
Short-term debt	<u>469</u>
United States	368
Japan	39
United Kingdom	24
Germany	17
Other	21
Medium-term debt	<u>478</u>
United States	285
Japan	41
Germany	21
United Kingdom	11
Other	120
Long-term debt	<u>558</u>
United States	189
Japan	130
IBRD	118
Other	121

12. Before public and private creditors would provide any financial assistance, they suggested that the Philippines accept guidance from the International Monetary Fund (IMF) in resolving the country's payments difficulties. Although initially opposed to what it considered outside interference, the Marcos Administration finally accepted IMF assistance in February 1970.

13. Manila's agreement with the IMF has led to an easing of the country's immediate debt repayment crisis. Several new loans were obtained, but the major relief resulted from debt rescheduling. A consortium of US commercial banks, the Philippines' major private creditors, agreed to reschedule approximately \$150 million of debt payments due this year,

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and a European banking consortium is expected to reschedule some \$30 million also due in this year. Scheduled repayments for 1971, however, have been only slightly reduced, and those for 1972 have been raised by \$100 million, with smaller increases in 1973-76 (see Table 5). Debt repayments during 1970-74 will total more than \$1.1 billion, or an average of \$225 million annually. This is equal to about one-fourth of total export earnings in 1969.

Financial Reforms and the Payments Balance

14. With IMF guidance, the Marcos government has attempted to improve the country's external payments position. In February 1970 a financial reform was implemented under which the peso was to float freely, its international value being largely determined by market forces.* The peso's value has already fallen by about 65%.** The government also limited short- and medium-term foreign borrowing and imposed internal fiscal and monetary restraints.

15. Manila is publicizing the claim that the financial reform vastly improved the country's balance of payments in the first half of 1970. During this period the trade deficit was only \$30 million, compared with about \$135 million for the same period last year. Exports jumped about \$80 million, or almost 20% above the 1969 first half level, while imports declined about \$25 million, or 5%. Because of this performance and with new foreign loans, Manila's foreign exchange position improved. By 30 September 1970, gross international reserves were \$205 million, compared with \$121 million at the end of 1969. The net reserve position increased only \$20 million, however (from minus \$70 million to minus \$50 million), because of an increase in short-term liabilities.

* Following a rapid initial decline in the international value of the peso, the central bank intervened in the market to limit the speed of any further devaluation and prevent large short-term fluctuations. Free market foreign exchange trading was suspended in early October.

** In dollar terms the peso's value has fallen by about 40% -- one peso now equals about 15.5 cents, compared with 25.6 cents before the monetary reform.

Table 5
Philippine Debt Schedule a/

	Million US \$									
	<u>1970</u>	<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>
Before latest rescheduling	540.1	228.0	156.1	114.4	88.8	53.3	46.6	40.1	27.5	33.1
After October rescheduling	361.4	215.6	251.8	147.4	148.8	120.1	82.2	40.1	27.5	33.1

a. On the debt owed as of April 1970.

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16. The sharp rise in the value of exports primarily reflects higher world market prices for the country's chief export commodities and thus has little to do with the financial reforms. Copper alone accounted for roughly three-fourths of the increase in exports during the first half of 1970, but higher prices represented about 40% of the rise in copper sales. Prices of other major exports also rose sharply in 1970. Prices for copra and coconut oil, for example, jumped 17% and 29%, respectively, during the first quarter because of sharp drops in sales volume. Sugar prices also rose, and with a record crop in 1969/70 the Philippines was able to increase exports to the US market because of a shortfall in Puerto Rican production. In the longer term the reforms could stimulate exports, but only if the exchange rate is maintained in a reasonable relationship to the internal price level. For the moment, part of the windfall from the devaluation in export production is being siphoned off by new export taxes and higher production costs.

17. The drop in imports probably is due to restrictive fiscal and monetary policies which caused industrial production to level off and probably caused investment to decline. The devaluation probably had little effect on total imports, but this was to be expected because it was designed primarily to replace direct controls as the principal means of controlling imports. Direct controls were eliminated for most raw materials, semi-manufactures, and smaller capital goods, although imports of finished consumer goods continued to be virtually banned.*

18. In the longer run the effect of the reforms on imports will depend on how effectively the increase in domestic demand is controlled through

* Since the February reforms, restrictions have been maintained on payments for certain imports, including most consumer goods and some producer goods such as automobile parts for assembly plants. Restrictions have also been maintained on payments for capital equipment valued at more than \$50,000. With such restrictions the Philippine government can easily delay in granting approvals for any type of import, and such delays probably do occur.

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fiscal and monetary policy and on exchange rate policy. Restrictive financial policies, coupled with the devaluation, have been maintained so far at a cost of slower economic growth, increased unemployment, and lower real wages. Consumer prices rose by about 12% between February and July 1970 because of the sharp increase in the prices of imported inputs into the manufacturing industry brought about by the devaluation, while, until July, there was little increase in wages.

19. In July, however, the government, under strong pressure from increasingly vocal urban groups, granted pay hikes and raised minimum wages by about one-third. The higher wages apply to nearly all workers in modern enterprise, including agriculture. The wage rise probably about compensated for the price increases, restoring real income levels. It will increase government expenditures and almost certainly force an expansion in private credit -- the alternative being a further rise in unemployment from an already high level. The result, therefore, is likely to be an expansion of demand, including the demand for imports. Unless the government is prepared to permit a further devaluation of the peso, which is problematical, it may soon be necessary to return to extensive direct controls on imports. The government has already required importers to make advanced deposits.

The Balance-of-Payments Outlook, 1970-74

20. Manila's balance of payments will have to improve markedly and for a sustained period if the country is to avoid continuing financial crises. Philippine government and World Bank planners believe that this can be done.* They estimate that export growth during 1970-74 will increase sharply to about 9.5% annually, compared to about 5% during the 1960s, while import growth will slow to 1% a year -- less than half that of the 1960s. Under

* Projections by the Philippines and World Bank were recently published, and they essentially agree. The major difference is that the World Bank believes that imports will have to grow by 3% annually during 1970-74 if the Philippines is to achieve its development goals during this period, while Manila projects a 3% average annual growth of imports.

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these circumstances the trade deficit would average roughly \$20 million a year. Net service payments of about \$80 million a year would raise the overall current account deficit to \$100 million annually on the average. Manila expects to finance this deficit and foreign debt repayments, while substantially increasing foreign reserves by means of increased foreign aid, private direct investment, and new commercial borrowing overseas. Accordingly, it is planning capital inflows of roughly \$370 annually for the 1970-74 period. We believe the estimates for both the current and capital account are highly unrealistic.

The Current Account Deficit

21. We estimate the current account deficit will average at least \$200 million annually -- double the Philippine estimate. Our major difference concerns export growth. The World Bank expects, and Manila apparently agrees, that illegal exports will fall dramatically, thus adding as much as \$100 million annually to official export earnings. While some reduction is possible, any large drop seems to us unlikely. Smuggling goods in and out of the Philippines with its seven thousand islands is not very risky. While devaluation should have reduced smuggling profits, potential illegal gains have been partially restored by export taxes. No perceptible movement of goods back into legal channels occurred during the first six months following the February 1970 devaluation. Another problem with the Philippine projection is the claim that nickel exports will total about \$125 million in 1974. Although mine development will soon get started, company officials project nickel exports will be worth only about \$70 million in 1974.

22. We estimate exports, at best, will grow by about 6% annually on the average over the next several years, about double that of the 1965-69 period (see Table 6). Almost half the increase will probably result from higher sales of minerals, which amounted to about \$180 million in 1969, or about 20% of total foreign sales of approximately \$875 million. A major boost will come from nickel sales scheduled to begin in 1971. Copper exports, on the other hand, after rising rapidly in 1970, are expected to change little thereafter because of

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Table 4
Philippine Exports

	Million US \$			Average Annual Growth Rate (Percent)	
	1966	1969	1974 Projection	1966-69	1970-74
Minerals	76	179	310	18.7	11.5
Timber products	178	259	310	7.8	3.5
Coconut products	247	160	200	-8.0	4.0
Sugar	171	158	205	-1.6	5.5
Others	85	115	150	6.2	5.5
Total	757	861	1,175	3.9	3.9

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lower world market prices and because production is expected to increase more slowly as major mine expansion programs have been about completed.

23. Agricultural exports are likely to grow slowly -- by about 4% a year during the 1970-74 period. With another record crop expected next year, sugar exports should increase considerably in the early 1970s, but are likely to level off later in the period because the US import quota will be filled. Exports of coconut products will increase slowly -- by perhaps 4% annually at best -- because of sluggish world demand which partly reflects increasing competition from palm kernel oil -- a good substitute for more expensive coconut oil. Moreover, the serious damage to coconut plantations caused by recent typhoons will further hurt export growth. Timber sales will probably grow little more than 3% annually because of deforestation. Roughly half our projected gains in exports of coconut products and timber are the result of expectations of reduced smuggling. Other agricultural exports will likely expand by around 5% a year primarily because of increasing sales of bananas and pineapples. Bananas and pineapples accounted for about 3% of total export earnings in 1969. Any increase in agricultural export prices is very doubtful. In fact they will probably decline, as sugar, coconut products, and lumber prices are expected to drop from the very high levels reached in 1969 and 1970.

24. The chances are dim the Philippines will increase overseas sales by developing exports of manufactured goods. Manila already enjoys a 40% preference in the US market under the terms of the Laurel-Langley Agreement, but has been unable to take advantage of its privileged position. Sales to the United States still consist overwhelmingly of traditional agricultural products, and manufactured goods account for less than 10% of total Philippine exports. By comparison, other East Asian countries which have enjoyed rapid export growth, such as South Korea and Taiwan, have been able to greatly increase their sales of manufactured goods to the United States even without preferential treatment. In these countries a favorable climate for foreign investors has led to development of export-oriented industrial sectors. This element is missing in the Philippines, and there is no reason to expect

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an improvement. The poor atmosphere for foreign investors more than offsets any attractions stemming from devaluation.

25. Unlike exports, over which the government has little direct control, Manila can theoretically hold down imports by applying restrictions. In practice, however, the Marcos administration will be hard pressed to limit import growth over a sustained period because the Philippine modern economy depends so heavily on foreign goods. With import growth projected at 3% a year during 1970-74, the pace of development will probably slow to a crawl because during the 1960s imports rose more than 7% annually to sustain an economic expansion of 4% to 5% annually. Efforts to reduce imports this year have already slowed economic growth sharply.

26. The balance on service transactions could be worse than planned. Although the government can exert some control over payments for such services as tourism and investment income, it has only limited influence on receipts from US military spending. Beyond US military cutbacks in the Philippines announced earlier this year, Manila has apparently not allowed for foreign exchange losses as a result of any future US military cutbacks in Vietnam.* In 1969, Vietnam-related US spending in the Philippines exceeded \$100 million. Manila, however, always has the option of further limiting investment income outflows and imposing other foreign exchange controls to offset any additional losses but at the cost of further discouraging new investments.

Financing the Deficit

27. We believe Manila's expectations on financing the current account deficit and debt repayments are highly unrealistic. Rather than the projected \$10 million annual inflow of private direct foreign investment, we expect the present outflow to continue.

* Foreign exchange losses resulting from reduced Vietnam-related US spending could offset any potential gains resulting from a movement of dollars from illicit channels into official channels. As indicated in Table 1, an increasing amount of service earnings moved into [Footnote continued on p. 18].

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Indeed, the trend toward disinvestment begun in the 1960s will probably accelerate during the 1970s. Manila already has made clear its intention to force US-owned firms exploiting natural resources to reduce their equity share to 40% after 1974, when the Laurel-Langley Agreement expires. Because of such demands, US firms could be forced to reduce their cumulative investment between \$200 million and \$400 million or possibly more. The process has already begun, and we believe the outflow of net direct foreign investment capital over the next several years is likely to range between \$30 million and \$40 million annually.

28. It is difficult to accept the Philippine/World Bank statements that foreign aid will reach \$200 million annually. Official foreign aid disbursements will probably increase somewhat above the average annual level of \$120 million of the late 1960s but are unlikely to exceed \$150 million a year. Existing aid commitments are already heavily drawn down and Manila is having trouble developing suitable projects for foreign financing. In addition, no major aid donors anticipate substantial increases in aid to the Philippines. The World Bank is attempting to develop an aid consortium for the Philippines, but it will be some time before any concrete results are seen.

29. New private long-term loans will also likely fall short of the \$160 million a year anticipated. Such loans averaged about \$100 million a year during the late 1960s -- before the country's financial problems came to light. Considering its poor credit position now, the level of these loans is not likely to increase much over the next several years. Recent statements by Japanese, European, and US bankers tend to confirm this. Manila will probably be able to obtain trade credits from firms trying to sell goods to the Philippines, but it will be difficult to get these in large amounts with medium- or long-term maturities.

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30. In sum, we expect Manila will obtain an average of from \$200 million to \$225 million annually in foreign capital over the next several years rather than the \$370 million planned on. These in-flows would be just about enough to cover the current account deficit, which we estimate will average \$200 million a year during 1970-74. Little, if any, therefore will be left over to meet scheduled debt repayments (see Table 7). Although depending on fluctuations in export prices and short-term credits, in any one year Manila might be able to meet a part of its obligations; it is clear, however, that over the period as a whole the country will be in no position to service its external debt. Even in the unlikely event that Mrs. Marcos' recent request for a \$300 million stabilization loan were met, this amount would cover debt repayments for only a year or so. The outlook then is for a continuing financial crisis in which Manila will have no choice but to resort to frequent refinancing of its foreign debt.

31. The controls needed to limit imports will strike hardest at the urban areas. Most imports are consumed by the manufacturing establishments there, and the slow economic growth and restrictions over government spending will add to the already serious unemployment problem. This leaves Manila in a dilemma because poor economic conditions are already exacerbating socio-political tensions. Consequently, there will be growing pressures on the government to stimulate economic activity. But this will mean raising imports faster than the 3% annual increase now planned and will result in a clearly intolerable balance-of-payments situation. On the other hand, stringent import restrictions would cause greater political dissension. The outcome of all this is likely to be an erratic import pattern, with imports first rising rapidly and then falling as restrictions are reimposed. Under these conditions, urban economic activity will be constantly disrupted, thereby providing constant irritants to urban workers who have become increasingly politically active.

32. The ruling oligarchy will almost certainly try to divert blame for the country's economic ills

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Table 7
Philippine Balance-of-Payments Projections

	Philippine estimates (1970-74 average annual)	CIA estimate of minimum deficit (1970-74 average annual)
	Percent	
Growth rate		
Exports	9.5	6.0
Imports	3.0	3.0
	Million US \$	
Trade balance	-20.0	-120.0
Net service payments	-80.0	-80.0
Current account balance	-100.0	-200.0
Private direct investment	10.0	-30.0
Foreign aid	200.0	150.0
Private medium- and long-term loans	150.0	100.0
Gross capital inflows	370.0	220.0
Less debt repayments a/	225.0	225.0
Overall balance	45.0	-205.0

a. Excluding repayments in debts incurred after April 1970.

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away from itself by playing on nationalist, basically anti-US sentiment. The US presence in the Philippines, including several major military bases and extensive business interests, is large and deeply rooted and consequently an easy target for both the Marcos government and its political opponents. Even so, Manila is likely to seek more aid from the United States to help finance its foreign exchange needs. The chances are, for example, that Mrs. Marcos' recent request for a \$300 million stabilization loan will be raised again.

Conclusions

33. Underlying economic and political problems manifested themselves in a sharp deterioration in Manila's balance of payments during the late 1960s. Failure to encourage new export industries left the country heavily dependent for its overseas sales on agricultural products, world demand for which has increased very slowly. Meanwhile, imports soared and growing trade deficits were financed principally by short-term borrowing. As a consequence, a large short-term external debt has been accumulated with a repayment schedule well beyond the country's capability.

34. At the behest of the International Monetary Fund and foreign creditors, the Marcos regime has taken some steps to resolve the balance-of-payments problem, including adoption of a partially floating exchange rate and restrictive monetary and fiscal policies. Although there has been some short-term improvement, factors other than devaluation are largely responsible. The recent increase in foreign exchange reserves was mainly due to new short-term borrowing. Exports rose sharply following the peso devaluation in early 1970, but primarily because of temporarily higher world market prices. Imports have fallen because of a slowdown in economic activity, but political pressures have forced the government to grant large pay raises which has increased the demand for imports.

35. We believe that Manila's expectations for improving its payments position in the longer term are overly optimistic. We estimate that the current account deficit will average at least \$200 million

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annually through 1974 -- about double Manila's own estimate. The major difference is that we expect exports will grow by at best 6% a year rather than Manila's 9.5% estimate. Demand for traditional exports is growing only slowly, and no new major export commodities are likely to boost earnings significantly. We also consider Manila's plans to obtain \$370 million annually in foreign capital highly unrealistic. A more likely level would be \$200 million to \$225 million. A capital inflow within this range would about offset the likely current account deficit, but in most years would be insufficient to service the external debt. Manila, therefore, is likely to join that group of other less developed countries that meet their foreign debt problems through frequent refinancing.

36. Given its serious foreign exchange constraint, Manila cannot expect to achieve measurable improvement of the country's already poor economic conditions. The economy is unlikely to expand appreciably faster than population growth rate. The only way to speed the growth process is to increase imports faster than now planned, but this would create an untenable balance-of-payments situation. If imports are held down, the effect will be slow economic growth, which in turn would further aggravate domestic political tensions. In any case, the ruling oligarchy will likely attempt to divert blame for the country's economic troubles on someone else by exploiting Philippine nationalism. As in the past, the United States will bear the brunt.

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